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MEMORANDUM FOR THE RECORD

SUBJECT: Assessment of OPEC

[redacted]

The attached was prepared by [redacted] for the Camp David Energy Meeting at the request of the Energy Resources Council. The paper was delivered to Mr. James Reddington on 13 December 1974.

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Attachment:
  As stated

Distribution: (S-6682)
  30 - James Reddington (OMB)
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   1 - NIO/Econ - [redacted] (Annex only)
   1 - O/DCI - [redacted]
   1 - D/OER

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Executive Summary

Assessment of OPEC

The price of oil has come to be essentially a matter of political decision and thus is difficult to predict. Nevertheless, OPEC members have very strong incentives to stand together on the price issue. If OPEC were to dissolve, there would be no natural floor for oil prices above the cost of production, and none of the members want to see the return of $2.00-a-barrel oil. Furthermore, Saudi Arabia -- the country with the greatest financial capability to cut production -- has strong political reasons to conform to the desire of other Arab producers to maintain high prices.

We thus foresee little strain on OPEC unity during the next few years. Production cuts totaling some 3 million b/d -- conceivably as much as 6 million b/d -- will be needed by next summer to keep world oil supply and demand in balance. Even a surplus of as much as 6 million b/d probably can be averted or worked off temporarily by unilateral production cuts. With the onset of winter, pressure on OPEC producers to hold down output will be reduced. In 1976-77, strains on OPEC nations to adjust their production to world demand should lessen, since recovery in economic growth probably will more than offset the impact of conservation measures on oil demand.

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Alaskan and North Sea oil will come on stream in the late 1970s, and the non-OPEC nations of the Third World are likely to become self-sufficient a few years later. By 1980, demand for OPEC oil will fall to a projected 22-24 million b/d -- or 4-6 million b/d below the current level -- and additional reductions in demand could be on the horizon. This situation almost certainly would require coordinated production cuts by OPEC members. We believe that almost all of the cuts would be absorbed by the rich Persian Gulf nations and Venezuela, with other OPEC countries continuing to produce at or near capacity. Saudi Arabia could easily reduce output by 4 million b/d. Declining reserves probably will force Venezuela to cut output by nearly 1 million b/d by 1980, whatever the market situation. The other million b/d probably could be divided among Iran, Kuwait, and the United Arab Emirates without too much acrimony. If the Saudis refused to cut output because of outside political pressure, we judge that the other OPEC nations would be willing to prorate a cut of up to 5 or 6 million b/d among themselves. In this event, these producers probably would boost prices to maintain revenues.

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ASSESSMENT OF OPEC

Characteristics and Policies

OPEC[1] is often described as a producers' cartel. Although it appeared to act as one last summer, the cutbacks then were made by individual states acting on their own, not as a co-ordinated group policy. Thus it still can be said that OPEC has not yet been put to the test.

The group has never been forced to act in the traditional manner of a cartel by allocating production to raise or maintain prices. It took advantage of the politically motivated Arab oil cutback to boost prices and then relied on a few members -- Kuwait, Venezuela, Libya, Iran, and Abu Dhabi.-- to cut output this past summer. Whether OPEC can or will act as a traditional cartel over the long term in the face of further drops in demand is still somewhat in doubt. The answer to this question lies in the political and economic situations of the principal OPEC members. In some cases, the personalities of leaders and the traditions and national character of the country are also important.

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[1] The members of the Organization of Petroleum Exporting Countries are Algeria, Ecuador, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, and Venezuela.

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The political imperatives that operate in these countries cannot be overlooked. No leader can afford to appear to accept the dictates of Europe or the United States. The appearance of "knuckling under to the imperialists" would create a domestic political situation very harmful to the party or person in power and be damaging to their international prestige. Moreover, leaders of all of the OPEC countries have a high regard for the organization itself; none want to be in a position where he would be accused of trying to "break OPEC."

Few OPEC leaders would risk serious domestic or international political problems for the sake of long-term economic gains. The horizons of most OPEC leaders -- Saudi Arabia's King Faysal and the Shah of Iran may be exceptions -- are limited to their lifetimes or tenures in office. Immediate domestic or international popularity is more important than potential benefits to future generations. Only if the welfare of future generations is a popular present-day issue would long-term economic considerations have much impact on current decisions.

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At the same time, the leaders are sensitive to accusations that they are enriching themselves at the expense of their oil-less Third World brothers. Some foresee a situation wherein they could be isolated from both the Third World and their traditional Western friends. [redacted] Fears of isolation and recession are partly responsible for the various schemes to channel some funds to the Third World and even to some industrial nations.

There have been no indications of an OPEC consensus that high oil prices will encourage the substitution of other fuels to the eventual detriment of the producer nations. The OPEC leaders' belief that there will always be an adequate market for oil at a high price -- as a petrochemical feedstock if not as a fuel -- is apparently sincere. Furthermore, most of them seem to believe that the price of oil-substitutes will remain greater than the price of OPEC oil and that each developed country will be reluctant to rely heavily on high-prices substitutes. These beliefs could change as the result of falling consumption and oil and gas development in non-OPEC areas.

In sum, we do not see any building OPEC consensus that prices are too high or unsustainable. Arguments that high prices will result in depressions in the developed world and disasters

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in the developing world have fallen mostly on deaf ears. The OPEC countries' collective inclination is to wait and see, while considering many and implementing some schemes to recycle a portion of their burgeoning revenues.

Decision Making in OPEC

An OPEC consensus that prices are too high is not a prerequisite to a price rollback. Present OPEC prices were only in part set by a consensus. The December price increase was engineered by the Shah with the support or acquiescence of most other members. The other OPEC members later participated in the further rises in prices that have resulted from changes in participation and taxes.

Three countries -- Venezuela, Iran, and Saudi Arabia -- aspire to leadership roles in OPEC. In both Venezuela and Iran the leadership can see the time -- within two decades -- when their oil production will drop drastically. Given this time frame, the prospect that technical advances and consumer's efforts to minimize oil imports could relegate OPEC oil to a minor role at the turn of the century is of no great importance.

For the Saudis, however, the value of oil in the marketplace several generations hence is an important factor. They see themselves producing enormous quantities of oil well into the middle of the next century. Thus their appreciation of the impact

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of present policies on the real value of their oil, 25, 50, or more years hence has considerable weight.

New Members

OPEC's membership is unlikely to expand much in the next few years. In an effort to keep OPEC from becoming hard to manage, the founding members may attempt to keep the club small by strictly interpreting the requirements for membership, which state that a country must be a substantial net crude oil exporter with interests fundamentally similar to those of other members. Each founding member -- Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela -- has veto power over new applicants.

Trinidad, Bolivia, and Malaysia have sought membership recently, and Peru and Mexico are likely to do so in the next several years as their oil production increases. One or two of these countries may gain full membership and the others probably will be offered associate membership, which carries no voting rights. Prospective OPEC members are unlikely to have much influence. They probably will follow the lead of the majority on important issues. In the future, the U.K., Norway, China, Mexico, and Malaysia will certainly have the potential to undertake substantial oil exports.

Trends in Supply and Demand

In 1975, demand for OPEC oil probably will continue to decline. Slowing economic activity throughout the developed

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world will reinforce the impact of higher prices and conservation measures on consumption. Furthermore, the normal pattern of inventory drawdowns is not expected to materialize. Thus, by mid-summer, demand for OPEC oil probably will fall by at least 3 million b/d from the current level. Crash conservation programs in several of the major consuming countries perhaps could increase the surplus by at much as 3 million b/d.

After 1975, as economic recovery begins to offset the continuing impact of conservation measures, OPEC exports will probably stabilize at about 26-27 million b/d. OPEC exports will begin to fall again, however, when new oil from Alaska, the North Sea, China, and perhaps Mexico begin to enter the market in major quantities in 1978-80. By 1980, OPEC exports probably will not exceed 22-24 million b/d.

Production Policies

OPEC's production policy for the foreseeable future will be to regulate output to meet demand and thus maintain the level of prices established by the group. Thus far, production cuts have been made on an individual basis, and no formal or informal production pro-rationing scheme has been agreed upon. OPEC will probably need to cut output further this coming summer, but it is not at all clear now how the cuts will be made, or which member will make them. What seems likely is that one or more countries will cut output outside the OPEC framework as they did this past summer.

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Similar moves to cut or raise output should be adequate to meet the small expected fluctuations in demand until the late 1970s. Kuwait, Libya, Iraq, the United Arab Emirates (Abu Dhabi), Ecuador, and Venezuela have all shown a willingness to voluntarily reduce their production substantially. Most other members have also made small voluntary production cuts.

In 1975, OPEC members will have estimated surplus revenues equivalent to about 18 million b/d of output (see the table). If Saudi Arabia refused to cut its output next year in the face of an oil surplus, the other members of OPEC, with surplus revenues equivalent to about 10 million b/d, could reduce output by 6 million b/d and still receive far more money than they could spend.

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OPEC Countries: Revenues and Expenditures 1975
(assuming current levels of oil output and Oct 1974 oil prices)

	Annual Export Revenues Billion $	Preliminary Estimates of Import Expenditures Billion $	Surplus Revenues Billion $	Surplus, in Millions of Barrels Per Day
Algeria	4.1	4.8	-0.7	-0.17
Ecuador	0.8	1.1	-0.3	-0.08
Indonesia	5.6	5.1	.5	0.15
Iran	21.3	10.2	11.1	3.08
Iraq	4.4	1.8	2.6	0.86
Kuwait	8.2	2.0	6.2	1.81
Libya	5.3	4.1	1.2	0.29
Nigeria	9.6	3.0	6.6	1.66
Qatar	2.0	.4	1.6	0.43
Saudi Arabia	32.4	5.0	27.4	7.71
U.A.E.	5.9	1.8	4.1	1.10
Venezuela	8.9	5.1	3.8	1.13
Totals	108.5	44.4	64.1	17.97

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The present massive excess of oil revenues above import requirements places nearly all of the member states in the position of being able to reduce production substantially to maintain prices. For now and the next couple of years, nearly all producers can act as price setters, with only Algeria, Ecuador, and Indonesia being forced by their import needs to act as price takers. As their expenditures rise, however, the number price setters will dwindle sharply. By the late 1970s, only Saudi Arabia, Kuwait, the Emirates and perhaps to a much lesser degree Libya, Iraq and Iran will still have the freedom to act as price setters.

During the next few years, the cartel will be able to cope with any likely oil surplus without Saudi participation, but by the late 1970s Saudi co-operation will be essential. Continuing slow energy demand growth combined with growing production of energy in the OECD, China, and non-OPEC Third World countries will force some formal or informal system of allocating cutbacks by 1978-80. If OPEC is to succeed in holding prices high late in the decade, the OPEC core -- particularly Saudi Arabia -- will have to cut back output much more sharply than OPEC as a whole, or must recycle revenues to other OPEC states to facilitate their cutbacks. Venezuela, although not in the position of a price setter, will also be reducing in output substantially as its oil reserves are depleted.

The need for sharp output cuts will greatly increase the influence of Saudi Arabia and Kuwait. These nations could afford to make the necessary cuts because they would still have ample resources.

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The alarming prospect of a quantum drop in oil income if the oil producers competed for market shares should serve to closely unite OPEC. One possible OPEC response would be to again sharply boost oil prices about 1980 or so, to recreate a widespread flexibility to cut output still further. Even if the Free World is highly successful in holding down the growth in energy consumption and in boosting domestic and other non-OPEC sources of energy supplies, it will still rely on the present members of OPEC to provide more than 20 million b/d of oil in 1980 -- down from about 29 million currently. Given this level of demand, there is no reason why OPEC would not be able to make the price increases stick -- at least for a few years. Because of the short-range considerations that govern the policy actions of most OPEC governments, it would be highly unlikely for them not to attempt such a move.

Price Policy

For the next few years, OPEC has indicated that it will probably attempt to maintain oil prices at about their current level in real terms. OPEC can be expected to make small periodic price increases to offset at least part of the increased cost of OPEC imports. Although the odds favor the adoption of some sort of price indexing system to tie oil prices to the prices of industrial and agricultural exports, it is not clear now how or when such a system would be implemented. Indexing is supported by the

OPEC Secretariat and many of the more important producers, especially Iran. Saudi Arabia, however, opposes automatic indexing. Thus, compromise seems likely with oil prices rising less than the cost of imports. In any event, price negotiations among he main producers will continue for years.

In the late 1970s and beyond, particularly if foreign exchange expenditures by the smaller producers and Venezuela rise rapidly, pressures will mount within OPEC for another sizeable boost in real oil prices. Indeed, the arithmatic of the situation will sooner or later push even the price setters into a situation from which the only escape -- albeit effective only for a few years -- will be to boost prices sharply. Such a move might be self defeating in the long-run but probably would be the only viable alternative available to the OPEC countries at that time.

As time goes on, and certainly by the late 1970s, many OECD nations will have strong vested interests in the maintenance of high energy prices. They will likely have protected their energy industries from fluctuations in world price levels. The U.K. in particular is an example of the strength of the vested interests which will have developed. Because of the large debts it is currently running up, it would be placed in a very difficult situation if oil prices fell sharply just as North Sea output reaches substantial levels. Similar, although less influential, vested interests will have been developed in most other OECD

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nations, as their domestic energy producing and consuming industries adjust their operations in response to high energy prices. Japan, because of its small domestic energy potential, is probably an exception among the major OECD nations.

On the producer side, Saudi Arabia may be an exception in that its petroleum production and pricing policies are motivated mainly by political factors. Considerations of Arab unity, the Israeli occupation of Arab land, and anti-communism play a large but undefinable role in Saudi petroleum policy formulation. Outside political pressure could also be important. Domestic political trends are not encouraging. There is a body of opinion in Saudi Arabia that favors high prices for economic and conservation reasons, and this group appears to be growing in influence. Moreover, the Saudis have clearly indicated that OPEC unity ranks high among its political objectives.

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If Saudi Arabia could be influenced to maintain output at current levels despite pressures from other producers, it is doubtful if any other producers would agree to go along with the Saudis. Even Abu Dhabi would probably be more swayed by economic considerations and Iranian pressure than by loyalty to Saudi Arabia.

Subgroup Behavior

Subgroups within OPEC are likely to put the whole organization's interests first, since for the most part they see their interests best served by it. Factions within the organization probably will not push any issues so far as to risk the breakup of OPEC. Although some subgroups, such as the Arab members, have the power to manipulate the market at the expense of other members, we believe they value the continued existence of OPEC more highly than short-term economic gains.

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The Organization of Arab Petroleum Exporting Countries (OAPEC) is the most important producer organization outside OPEC. It was formed in 1968 by Saudi Arabia, Kuwait, and Libya -- then headed by King Idris. OAPEC's principal goal was the coordination of oil policies among the moderate Arab countries. Despite the change in Libya's government and the addition of new members (some not large enough exporters to merit OPEC membership) -- Algeria, Bahrain, Egypt, Iraq, Qatar, Syria, and the United Arab Emirates -- Saudi Arabia is still the driving force behind OAPEC.

The actions taken for political reasons to reduce production and the embargo of selected countries during and after the October war were a sharp deviation from OAPEC's main objective. Under Saudi leadership, OAPEC is likely to continue to stress the long-term economic goals of the organization such as its Arab tanker fleet and the Bahrain dry dock project. Short of major deterioration in the Arab-Israeli situation, the OAPEC countries are unlikely to take action outside the OPEC framework to manipulate oil prices or production.

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Almost two years ago, 22 Latin American and Caribbean countries agreed in principle to establish a regional energy organization, Organization Latinoamerica de Energia (OLADE).[2] OLADE's principal objectives are:

- o Development of Latin American energy resources with the use of the most advanced technology.
- o Higher prices for oil shipped to industrialized countries.
- o Direct government-to-government agreements between oil-producing countries of OLADE.
- o Uniform policy by OLADE countries toward foreign oil companies.
- o Use of oil by OLADE's oil-producing countries as a lever.

OLADE has yet to be officially put into operation. The members have been unable to agree on the basic document to set up the organization. The diversity of views among the original signatories probably will continue to hamper OLADE's effectiveness

We do not foresee a breakup of OPEC for at least for the next several years. In addition to its role in setting oil prices, the members value the organization's continued existence as a forum for exchanging ideas and information, OPEC's membership probably will not expand much in the next few years,

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[2] The members of OLADE are Argentina, Bolivia, Brazil, Chile, Columbia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad, Uruguay, and Venezuela.

and prospective members are unlikely to have much influence. Subgroups within OPEC are likely to put the whole organizations's interests first, since, for the most part, they see their interests best served by it.

A Natural Gas Cartel?

Some OPEC members are considering the establishment of a cartel for liquefied natural gas -- LNG. OPEC, because of the large production of associated gas and the ownership of major non-associated gas deposits, control about 56% of total known Free World natural gas reserves. This is much smaller than their 83% of control over known Free World crude oil reserves, however, and will give them less leverage in controlling prices. In any event, a ceiling on LNG prices will be set by the level of crude oil prices. The LNG industry is still in its infancy and any OPEC move to set prices higher than market forces would allow, will greatly slow its development. OPEC will probably try to hold gas prices at least as high as crude oil on a delivered BTU basis, so as not to lose from the substitution of gas for oil. Because the consuming countries do not now depend on OPEC owned natural gas, OPEC has little leverage and would gain little benefit by forcing gas prices above oil prices.

ANNEX 1

POSITIONS AND ATTITUDES OF OPEC MEMBERS

From an economic point of view, OPEC members can be divided into three groups, with some overlap.

- First, Saudi Arabia, Kuwait, Libya, Qatar, and the United Arab Emirates, which do not operate under any important economic restraints. These countries have ample oil reserves and as much income as they can effectively spend under any foreseeable price or production level.
- Second, Iraq, Iran, Nigeria, Indonesia, and Algeria, the heavily populated countries with ambitious development plan. These states lean toward whatever combination of price and production maximizes revenues. Within this group, the financial pressure is much greater on Indonesia and Algeria than on the other states.
- Third, Venezuela, Ecuador, and Algeria, which are concerned about declining oil reserves and give conservation an important place in their policies. If substantial new reserves are not discovered in Indonesia and Nigeria, these countries also will become increasingly concerned about conservation.

The following sections sketch the factors that differentiate the principal states make up OPEC.

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Algeria

Background

Algeria in the 1970s is being transformed from an agricultural to an oil-producing economy. Petroleum and natural gas account for 18% of GDP and three-fourths of exports. Algeria is richly endowed with natural gas, but its known oil reserves are realtively small. The country has a larger population (16 million) and a lower level of oil reserves than most Persian Gulf oil states. In 1973 per capita GNP was less than $500, but is expected to double by the early 1980s. Development efforts have led to large foreign debts, but the country has maintained its credit-worthiness because of potential oil and gas income. Since the nationalization of most of the oil industry in 1971, only three foreign companies have a share in oil production (two French and one American). Sonatrach, the state-owned company, controls about 80% of output.

Prospects for Spending Oil Revenues

Algeria has more absorptive capacity than most of the oil producers of the Middle East because of its large population, good infrastructure, and the industrialization and modernization started under the French. Crude oil production capacity will probably increase to about 1.4 million b/d by 1980 from the current level of about 1 million. 25X1

Developmental expenditures of the central government in 1974

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are expected to rise to $2.2 billion, 55% more than in 1973. In addition, administrative budget expenditures are to be increased 19% to $1.7 billion. Spokesmen place the total cost of a 4-year development plan through 1977 at $28 billion. Three-fifths will be directed to industry, but education and training will receive high priority as well. Little in the way of military purchases is planned.

Algeria, although it aspires to OPEC leadership, is clearly a price taker. It needs all the funds it will acquire through oil and gas revenues to advance its ambitious development program, service a large foreign debt, and provide expected government services. The government has strongly supported price hikes for oil and would increase prices further if possible, but would be reluctant to reduce output further. The algerian attitude on oil prices reflects (a) the fact that absorptive capacity probably will exceed oil revenue in any case; (b) the small size of oil reserves; and (c) good prospects for developing other exports. Algeria thus is willing to sacrifice long-run income for short-run income from oil.

<u>Position on OPEC Issues</u>

Despite an emphasis on production, Algiers has been willing to sacrifice for OPEC causes that it considers worthy. It has opposed meeting with consumers, and President Boumediene was an outspoken critic of the Washington Energy Conference. The government fears that meetings could result in a special relationship between large consumers and large producers that

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might be inimical to Algeria's interests. President Boumediene proposed the April UN General Assembly debate on world economic problems. In the debate, Algiers advanced the classic terms-of-trade argument that LDCs are forced to sell cheap and buy dear and the corollary that petroleum cartels and other possible cartels of raw materials producers are justified. Algeria also advocated nationalization of raw material production in LDCs, and the removal of such middlemen as the international oil companies.

Algeria: Economic Fact Sheet

	1965	1970	1973	Estimated 1974
	Million Persons			
Population	12.0	14.3	15.7	16.2
	Thousand B/D			
Crude oil production	600	1,000	1,100	930
	Billion US $			
GNP	3.4	5.5	7.5	11.5
Government oil revenues	0.1	0.3	1.0	3.7
Foreign exchange expenditures	0.6	1.1	1.5	3.9
Foreign exchange reserves	0.2	0.3	1.1	2.1

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Ecuador

Background

Ecuador's economic situation has improved markedly since the beginning of the petroleum boom in mid-1972. Last year, real GNP grew by about 15% to $2.3 billion, boosting per capita income to $350. Government oil revenues, which totaled some $200 million in 1973, are being used primarily to finance increased spending on social and economic infrastructure. The 1973 budget registered a $4.6 million surplus, compared with a deficit of $20 million in 1972.

The increased inflow of petroleum dollars, while stimulating economic growth, has added substantially to inflationary pressures. Consumer prices rose 18% last year. During the first 7 months of this year, prices climbed an alarming 16%. Inflation and shortages of basic foodstuffs are creating difficulties for the government.

Since the present regime took power in 1972, Quito has increased its control over the petroleum industry. Shortly after taking office, the Rodriguez government implemented a new hydrocarbons law calling for renegotiation of existing contracts with foreign oil companies; several concessions were returned to state ownership. Texaco-Gulf, which produces 99% of Ecuador's oil, was forced to sign a contract returning all property to the state at no cost in 20 years. Earlier this year the government purchased 25% equity in the consortium's local operations. The Trans-Andean

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pipeline, now owned by Texaco-Gulf, will become the property of Ecuador when amortization is completed, probably in 1978.

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Prospects for Spending Oil Revenues

[redacted] stands to receive oil revenues of about $500 million in 1975. Most of the increase in oil revenues this year will be used for current government operations, a 30% rise in subsidized food imports, and military procurement. Additional spending on economic development is not expected to be large. Ecuador soon will spend all of its surplus revenues and will clearly be in the position of a price taker.

Position on OPEC Issues

As a new member of OPEC and a relatively small oil producer, Ecuador probably will maintain a low profile in OPEC. It probably will follow Venezuela's lead in opposing any move to lower prices. Because of conservation considerations and its inability to absorb much larger oil revenues, Ecuador was more willing than most oil exporters to reduce output this year. Quito probably would approve establishing a development fund to aid LDCs if its contribution is minimal.

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Ecuador: Economic Fact Sheet

	1965	1970	Estimated 1973	1974
	Million Persons			
Population	5.1	6.0	6.6	6.9
	Thousand B/D			
Crude oil production	negl	negl	200	180
	Billion US $			
GNP	NA	1.2	2.3	2.5
Government oil revenues	--	--	0.2	0.5
Foreign exchange expenditures	NA	NA	0.6	0.6
Foreign exchange reserves	negl	0.1	0.2	0.5

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Indonesia

Background

Indonesia is one of the poorest nations in OPEC and is by far the most populous. About two-thirds of the nation's 130 million people are crowded onto the island of Java, which includes only 8% of the available land area. Per capita annual income remains less than $100. Financing the nation's cumbersome debt burden inherited from previous political administrations and extensive development projects will absorb the highest oil revenues obtainable.

While Indonesian oil resources make up only a small fraction of world reserves, recent rapid growth in crude production and the low-sulfur qualities of oil produced contribute to Indonesia's increasing importance as a world supplier. Recent impressive reef-type oil discoveries have the potential to push crude output to around 3 million b/d by 1980. Reinforcing this bright prospect is the expected surge in natural gas production that will be processed into LNG by two large plants due to come on stream in the late 1970s.

The country's oil resources for the most part are exploited by private companies acting as contractors for the state oil and gas company, Pertamina. Although the government is the de facto owner of all facilities involved in oil exploration and development, the control exercised is minimal. The nation maintains good working relations with the foreign oil companies that have interests there.

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Prospects for Spending Oil Revenues

On 1 April 1974, Indonesia instituted its Second Five-year Plan aimed at establishing social and economic equality for the population. Planned development expenditures for the five years ending in 1979 are put at $11.7 billion, with Indonesia's share of the financing scheduled to increase from 62% in the first year to 85% in the final year. In addition to ~~contributing~~ to the funding of development plans, oil earnings in recent years have financed 40% of current budget expenditures and will undoubtedly continue to be important in this respect. Indonesian economic needs to support the continuing pressure of population increases are enormous. Scheduled public investment expenditures will average about $2 billion annually during the plan period, and debt amortiziation payments will run at $380 million annually for the next decade. Import requirements will remain high and development projects will be essential to provide employment for the burgeoning population.

Despite these requirements, the great expansion in petroleum revenues of the recent past and now in prospect radically alters Indonesia's need for external financing. In 1974 petroleum earnings alone will amount to over $4 billion and, even in the face of increased Indonesian imports, there will be a current account surplus on the order of $1 billion for the first time in postwar history. The outlook for continued growth in export earnings from both oil and non-oil commodities is good over the next 4 to 5 years, even

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under conservative projections. Although the demand for external technical and project preparation assistance will continue, some of these development needs will be covered by the country's strong ability to attract private capital. Under these conditions Indonesia will only begin to experience serious foreign exchange constraints on growth in the late 1970s if oil prices plummet, or if the scope of the present development scenario is greatly expanded.

<u>Position on OPEC Issues</u>

Indonesia's stand on issues likely to be raised by OPEC will reflect the nation's massive current and growing needs for foreign exchange. A production-prorationing scheme would be resisted by the Indonesians, probably to the point of requesting exemption or withdrawing from the organization. This sentiment was expressed by government officials and leaders of Pertamina after the Arab actions of last year. While Jakarta is overtly sympathetic with the Arab cause, its own welfare is uppermost, and any cutbacks in production would directly impinge on that interest. Indonesia's ability to maintain an independent position is bolstered by the high demand for its low-sulfur crude and the knowledge that, as a small producer, it would reap little benefit by holding back output.

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On the issues of establishing closer relations with consuming nations and the role of international oil companies, Indonesia is likely to be much less contentious than most of the larger producing countries. The uninterrupted flow of crude is as important to Indonesia as it is to consumers. Jakarta already has shown signs that it wants to remain cordial with its primary oil customers, Japan and the United States.

Indonesia: Economic Fact Sheet

	1965	1979	1973	Estimated 1974
		Million Persons		
Population	105	118	130	133
		Thousand B/D		
Crude oil production	500	900	1,300	1,400
		Billion US $		
GNP	NA	8.1	14.3	18.6
Government oil revenues*	NA	0.1	0.9	4.3
Foreign exchange expenditures	0.9	1.6	4.1	6.5
Foreign exchange reserves	NA	0.2	0.8	

*Net foreign exchange earnings.

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Iran

Background

Huge oil revenues have drastically changed Iran's outlook for government income and expenditures. Instead of a deficit and a need for heavy borrowing, the country is now faced with the prospect of having revenues in excess of viable spending options. Iranian GNP, which has been growing at an average rate of 10% a year since the mid-1960s, will jump in 1974 by 20%, excluding the oil industry, or by more than 50%, including oil. Per capita GNP for Iran's 32 million people will rise to about $1,200 this year. Oil revenues are expected to reach some $18 billion in 1974 and to contribute about 45% of the GNP.

Iran's government has full ownership of the oil industry. Iran has the capacity to increase oil output from the current rate of about 6 million b/d to 8 million b/d in the next few years and to hold that rate for at least a decade. Recent proposals suggest, however, that Tehran will hold output below capacity to prolong the productive life of the oilfields. During the period of maximum oil production, the Shah hopes to see Iran transformed into a major industrial power, on the scale of France or West Germany today. Though unrealistic, this objective does give the Shah strong reason to want the price of oil high.

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Prospects for Spending Oil Revenues

The Shah is trying to adjust to the new financial situation by raising development spending, promoting a more rapid build up in defense, increasing foreign aid, and reducing the large outstanding debt. Even so, Iran probably will accumulate surplus revenues of at least $9 billion this year. If oil prices and Iranian oil output continue at present levels, Tehran probably will not be able to spend all its revenues until the late 1970s.

Iran faces difficulties in trying to accelerate economic development. The sustained high growth of the past decade has strained resources, creating bottlenecks in transportation, technical services, and industrial inputs. Rapid growth also has nourished a high rate of inflation. Iranian plans for developing industry, transport, and telecommunications will require substantial purchases of materials and technical assistance from abroad. Imports of all goods and services in 1974 may reach nearly $7.6 billion, compared with $6 billion in 1973 and $2.6 billion in 1972. Even expenditures of this magnitude would leave a current account surplus of more than $10 million.

The Shah has always given a high priority to defense; in recent years he has intensified the military buildup in line with his concept of a widening role for Iran in the

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Persian Gulf and the Indian Ocean. Spending on defense, including debt repayment, absorbs about one-third of the budget. In 1974/75, outlays will amount to about $4 billion. Future buildup of the military forces will require continued purchases abroad of sophisticated, expensive military equipment. In addition, Iran is seeking to import plants to product armaments.

<u>Position on OPEC Issues</u>

Iran has proposed a major multilateral aid program for the LDCs. The Shah is interested in financing development in selected countries to promote his political objectives and to complement Iranian economic development. Iran has invested in the UK and France as well as a number of less developed countries. The amounts of such investments has reached some $7 billion and more is on the way.

The Shah was instrumental in founding OPEC and has proposed a new pricing system which would do away with a 2-tiered pricing system. The Shah believes that current oil prices are justifiable, considering the price of alternative energy sources and the prices of Iran's industrial imports. Furthermore, he believes that high oil prices will not in the long run jeopardize his relationship with the West.

Iran has provided some de facto price concessions, in the form of easy repayment terms, on oil shipments to India. The Shah has agreed to provide India with credits to develop industries that will contribute to Iran's development and is surveying similar investment opportunities in countries producing raw materials needed in Iran.

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Iran: Economic Fact Sheet

	1965	1970	Estimated 1973	Estimated 1974
	Million Persons			
Population	23	28	31	32
	Thousand B/D			
Crude oil production	1,900	3,800	5,900	6,000
	Billion US $[1]			
GNP	11.7	17.4	26.0	40.0
Government oil revenues	0.9	1.9	7.5	18.0
Foreign exchange expenditures	NA	3.0	7.0	8.0
Of which:				
Imports	NA	2.6	6.0	7.6
Foreign exchange reserves	0.2	0.2	1.2	9.0

1. Financial projections are in 1974 dollars

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Iraq

Background

Iraq was one of the poorest nations in the Persian Gulf area. Even with a 26% increase in GNP in 1973 to $5.8 billion, its more than 10 million people had a per capita income of only $500*. Until the recent oil price hikes, Iraq had not achieved rapid economic growth for some time. Between 1960 and 1971, per capita GNP grew by just 2.4% per year, partly because oil revenues grew only slowly and partly because the government was unable to effectively organize economic development.

Under the radical Baath regime, Iraqi economic policy often has been strongly influenced by ideology and political expediency. The government has given priority to expanding state ownership and control in the modern sector rather than increasing production. All major industries have been nationalized, including most of the oil industry. The government now owns 80% of Iraq's oil production through the two national oil companies, the Iraq National Oil Company (INOC) and the Iraq Company for Oil Operations (ICOO).

Petroleum earnings provide 65% of government revenues, 90% of foreign exchange earnings, and nearly one-third of GNP. The country has proved reserves in excess of 31 billion barrels and is investing heavily in new exploration.

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*This year per capita income nearly doubled (to $975) as GNP is expected to reach $10.7 billion.

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Prospects for Spending Oil

Iraq is now earning larger oil revenues than it can spend. These revenues, which amounted to about $600 million in 1972 and $1.7 billion in 1973, are expected to reach $6.4 billion this year. Because of organizational constraints and inadequate managerial and technical manpower, public investment probably cannot be increased to more than $2 billion this year. Iraq thus promises to have surplus revenues of roughly $4 billion.

To use some of its growing revenues, the government is seeking to increase downstream investments in the oil industry. A major expansion of refinery capacity is planned, since current refinery capacity can accommodate less than 10% of crude oil production. The government-owned tanker fleet also will be expanded. Half of Iraq's ambitious industrialization plan involves petrochemical projects. Several plants to produce plastics, fertilizer, and other goods will be built under economic and technical agreements negotiated with France, Austria, Japan, Spain, Yugoslavia, Egypt and Italy.

The Iraqi military regime also can be expected to spend heavily for additional military hardware. Even before the windfall of higher oil prices, the government devoted nearly half of its current expenditures to defense, at the expense of economic development. In FY 1973/74, $477 million was budgeted for defense; in 1974/75 this will rise to $800 million.

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Position on OPEC Issues

Iraq is often described as the "maverick" member of OPEC because of its willingness to adopt oil policies in conflict with those of other members. It responded to the recent Arab-Israeli war with nationalization and increased production rather than following the OAPEC agreement to cut production. When the other producers ended the boycott against the United States and the Netherlands, Iraq dissented strongly and continued the boycott. Iraq has been planning a substantial increase for oil output within the next two years. But in the face of both Western and Communist resistance, it recently curtailed oil output in lieu of accepting lower prices. The Iraqis might support an OPEC-wide cutback in output to support current prices if they believed cooperative action would attain its objectives within a realtively short period of time.

Iraq: Economic Fact Sheet

	1969	1970	1973	Estimated 1974
	Million Persons			
Population	8.1	9.5	10.7	11
	Thousand B/D			
Crude oil production	1,300	1,600	2,000	1,850
	Billion US $			
GNP	2.5	3.7	5.8	10.7
Government oil revenues	0.4	0.5	1.7	6.4
Foreign exchange expenditures	0.4	0.5	0.8	2.5
Foreign exchange reserves	0.2	0.5	1.5	5.5

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Kuwait

Background

Oil is Kuwait's only real asset, providing about 80% of foreign exchange earnings and more than 85% of government revenues in 1973. Oil revenues in 1974 will total about $7.3 billion, pushing GNP to about $9.5 billion, compared with $4.4 billion last year. Kuwait's foreign assets reached an estimated $4.5 billion in 1973 and may well surpass $8.8 billion in 1974.

Prospects for Spending Oil Revenues

Even with relatively slow growth in production, Kuwait has had substantial surplus funds to invest since the early 1960s, primarily because of its small size and population. Although the government is becoming increasingly active in exploring ways to spend money, it will be hard pressed to substantially increase spending on internal development or military procurement and training. Substantially increased funds, however, probably will be disbursed as foreign aid.

Position on OPEC Issues

Kuwait's oil policies generally follow the middle-of-the road approach of its foreign policy. Because Kuwait has a massive foreign exchange surplus and needs to conserve its oil resources to assure a continued flow of revenue in the long term, the government placed a ceiling on production in 1972 and has held firm to that decision. Kuwaiti production was further restricted during and after the October war and has

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not been increased to its pre-war level even after the US embargo was lifted.

Kuwait: Economic Fact Sheet

	1965	1970	1973	Estimated 1974
	Million Persons			
Population	475	700	1,000	1,100
	Thousand B/D			
Crude oil production	2,300	3,000	3,000	2,500
	Billion US $			
GNP	2.0	3.1	4.4	9.6
Government oil revenues	0.7	0.9	1.9	7.3
Foreign exchange expenditures	NA	NA	1.7	4.1
Foreign exchange reserves	0.9	2.0	4.5	8.8

1. Including approximately one-half of Neutral Zone production.

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Libya

Background

Libya, with a population of only 2.2 million, will achieve a GNP of $7 billion in 1974. The oil sector accounts for more than $5 billion of this income.

Prospects for Spending Oil Revenues

Libya's ability to use its enormous oil income is restricted by lack of human resources and by the highly conservative policies of President Qadhafi. Qadhafi refuses to use oil revenues directly to raise consumption levels. Investment is constrained by a shortage of skilled Libyan labor coupled with Qadhafi's aversion to the use of foreign technicians. Qadhafi seeks to impose the rigid Muslim ethic on external economic transactions, rejecting many investment options and refusing to transfer cash to most client states.

Position on OPEC Issues

Neither OPEC nor any other multi-national organization can count on the attitude of Qadhafi. At present, he is pursuing his own aid program. He probably will continue to be a loner, placing Libya's individual welfare and "higher" Islamic goals above the aims of OPEC.

Libya: Economic Fact Sheet

	1965	1970	Estimated 1973	Estimated 1974
	Million Persons			
Population	1.6	1.9	2.1	2.2
	Thousand B/D			
Crude oil production	1,200	3,300	2,200	1,500
	Billion US $			
GNP	1.4	3.4	4.6	7.0
Government oil revenues	0.4	1.2	2.3	5.0
Foreign exchange expenditures	0.5	1.0	2.2	2.9
Foreign exchange reserves	0.2	1.6	2.1	3.6

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Nigeria

Background

Nigeria's booming oil industry gives the country a considerable advantage over other African nations in planning for sustained growth. Nevertheless, its petroleum income is not large when related to the needs of the population. Although oil production has temporarily removed the foreign exchange constraint on development, Nigeria still faces enormous problems in developing and administering a program that will significantly improve the standard of living of its 80 million people. Nigeria's proved recoverable reserves amount to about 20 billion barrels, representing 25 years of production at the current rate. Potential reserves are believed to be much larger. Long-term prospects are also favorable for export of natural gas because gas reserves are estimated at 40 trillion cubic feet.

Prospects for Spending Oil Revenues

Despite rapidly growing current expenditures in recent years, revenues available to Lagos for public investment have increased tremendously. If oil prices remain at the present level and Nigerian oil output grows slowly, revenues will exceed the economy's absorptive capacity for some time. If Nigeria were able, for example, to increase public investment by 20% annually for the next five years, spending would still be somewhat below revenues.

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Nigeria could choose from a number of other possibilities to dispose of some of its increased revenues. These include partial or complete liquidation of some $2 billion of internal debt and $400 million of external debt; elimination of delays in paying for imports, which would absorb about $460 million; increased revenue allocations to the states; increased transfer of funds to the private business sector through the Nigerian Industrial Development Bank and the Nigerian Bank for Commerce and Industry; and substantial equity purchases in large-scale industry.

Position on OPEC Issues

Nigeria has been satisfied to leave the leadership role in OPEC to the Middle East producers and to move in step with OPEC. Its main objective has been to maximize oil revenues. Overall it has been concerned with maintaining a reasonable posture in its relations with companies and consumers.

Nigeria: Economic Fact Sheet

	1965	1970	1973 (Estimated)	1974 (Estimated)
	Million Persons			
Population	64	72	79	80
	Thousand B/D			
Crude oil production	300	1,100	2,100	2,300
	Billion US $			
GNP	4.3	6.0	14.0	20.0
Government oil revenues	negl	0.3	2.4	9.0
Foreign exchange expenditures	1.5	2.1	3.2	4.0
Foreign exchange reserves	0.2	0.2	0.6	6.0

Qatar

Qatar is a minor oil producer. It has been a leader, however, in acquiring majority (60%) ownership and in negotiating buy-back prices. Oil completely dominates the economy, accounting for 95% of foreign exchange earnings and 90% of government revenues. Institutions for investing rapidly increasing revenues have not yet been developed. The government has asked for IMF assistance in developing a monetary agency. Qatar is likely to take a back seat in OPEC and OAPEC controversies, complying with the decision of large producers, primarily Saudi Arabia.

Qatar: Economic Fact Sheet

	1965	1970	1973	Estimated 1974
	Thousand Persons			
Population	68	79	89	93
	Thousand B/D			
Crude oil production	229	368	570	570
	Billion US $			
GNP	0.1	0.2	0.5	1.6
Government oil revenues	0.1	0.1	0.4	1.5
Foreign exchange expenditures	NA	0.1	0.3	0.6
Foreign exchange reserves	NA	0.2	0.4	1.4

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Saudi Arabia

Background

Except for the oil industry, the Saudi Arabian economy still is backward. Agriculture and related pastoral activities support about half of the 6 million people. Agriculture, government services, handicrafts, construction, commerce, and the tiny industrial sector will account for only about 15% of the estimated $28 billion GNP for 1974. The remainder will be generated by the petroleum industry. The country must rely heavily on imports for supplies of food, other consumer goods, construction materials, and industrial equipment.

Saudi Arabia has the greatest potential among oil producers for extremely rapid increases in oil production, yet it has little economic incentive to raise output. The country was unable to spend all of its $5.5 billion oil income in 1973, and income will increase to as much as $25 billion in 1974. Foreign exchange assets amounted to $4.3 billion in March 1974 and are likely to exceed $20 billion by the end of the year. Regard for the welfare of future Saudi generations makes oil conservation policies attractive. On the other hand, because the Saudis expect to be in the oil business for a long time, they have an interest in maintaining orderly markets in a prosperous world. They thus have some incentive to produce more oil than is dictated by current revenue needs. The government owns 60% of Aramco -- which

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accounts for nearly all oil production -- and is currently negotiating for 100% ownership.

Prospects for Spending Oil Revenues

Spending cannot possibly be increased enough to absorb most Saudi oil revenues, because the country's absorptive capacity is limited. Foreign exchange expenditures in 1974, for example, probably ~~will not exceed~~ $5.5 billion, leaving a surplus of some $19 billion. Even under the most generous assumptions, spending will fall far short of revenues during the remainder of this decade and probably beyond.

Position on OPEC Issues

Saudi Arabia values OPEC highly as an organization. Saudi views on oil matters are also conditioned by the Arab-Israeli conflict. Secular power in Saudi Arabia is concentrated in King Faysal, and politics is highly personalized and centralized. By custom and necessity, Faysal consults often with members of the royal family, proteges, personal advisers, commoners high in the bureaucracy, and other leaders of the society. Although Faysal makes final policy decisions, he takes advice and attempts to rule through consensus. Thus the King moves slowly and carefully.

The Saudis earlier this year indicated that they favored a reduction of the posted price for oil. Thus far they have not favored any pro-rationing scheme to maintain oil prices, but could go along if other OPEC nations initiate it. They have repeatedly indicated that they will not unilaterally take steps to destroy OPEC. The Saudis recognize

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the inevitability of consumer-producer meetings but will move cautiously.

Saudi Arabia: Economic Fact Sheet

			Estimated	
	1965	1970	1973	1974
	Million Persons			
Population	4.5	5.2	5.8	6
	Thousand b/d			
Crude Oil Production[1]	2,200	3,800	7,600	8,500
	Billion US $			
GNP	2.3	4.0	8.8	28.0
Government oil revenues	0.6	1.2	5.5	24.6*
Foreign exchange expenditures	0.5	1.2	3.2	5.5
Foreign exchange reserves	0.7	0.7	3.9	23.0

1. Including approximately one-half of Neutral Zone production.

*Assumes $3.2 billion in retroactive oil payments are made.

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United Arab Emirates

The United Arab Emirates is economically and politically one of the least developed of the major oil producers. Only three of the seven emirates which make up the UAE presently produce oil. The largest producer, Abu Dhabi, dominates the UAE. The emirate's leader, Shaikh Zayid, is primarily responsible for keeping the UAE together.

With a total UAE population estimated at about 230,000, expected 1974 oil revenues of more than $5 billion, and potential annual surpluses of $3 billion through 1980, Abu Dhabi, the major producer, is limiting its 1974 production. Future production levels will be based on field depletion, crude oil prices, the amount of income the UAE/Abu Dhabi can absorb for development and for meeting outside aid commitments, and the attractiveness of investment opportunities for surplus funds. Thus far, neither the UAE nor the individual emirates have developed institutions that can effectively handle rapidly expanding surpluses.

In international oil matters, the UAE can be expected to follow the Saudi lead so long as it does not impinge upon Shaikh Zayid's view of his own position as a major oil producer. During the October war, for example, he temporarily balked at making the OAPEC-ordered production cut because he wanted to build up funds to contribute to the Egyptian and Syrian war effort. In any intra-OPEC squabbling between Saudi Arabia and other producers, Shaikh Zayid would take the Saudi side. [redacted] 25X1

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UAE: Economic Fact Sheet[1]

	1965	1970	Estimated 1973	Estimated 1974
	Thousand Persons			
Population	165	190	225	230
	Thousand B/D			
Crude oil production	300	800	1,500	1,700
	Billion US $			
GNP	NA	0.3	1.2	5.8
Government oil revenues	negl	0.3	1.1	5.6
Foreign exchange expenditures	NA	0.5	1.0	2.2
Foreign exchange reserves	NA	0.2	1.3	5.3

1. UAE was formed in December 1971. Earlier data, when available, consist of aggregating individual member data.

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Venezuela

Background

Largely because of the dramatic increase in petroleum export earnings, the Venezuelan economy expanded at an accelerated rate in 1973. Real GNP increased 6%, but rapid population growth held the per capita rise to about 2.5% Government oil revenues rose about two-thirds, to an estimated $3.0 billion. By the end of 1973, Central Bank foreign reserves had reached $2.4 billion, 40% higher than the level a year earlier. Despite rapid growth in other sectors, petroleum in 1973 accounted for 90% of export earnings, two-thirds of government revenue, and one-fourth of GNP.

The Perez government, inaugurated in March, intends to advance the takeover of oil company concessions to 1975 rather than the previously scheduled reversion to the state beginning in 1983. The government is considering several proposals for organizing the industry after nationalization. The proposal most likely to be adopted retains the structure of at least three major companies and merges the remaining firms. The four companies will operate under the control of a national petroleum enterprise. Some of the present oil companies may provide management and other services under contract and probably will market a large share of Venezuela's production.

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proved reserves declined during 1960-74 from 17 billion barrels to 14 billion barrels, which equals about 13 years' production at current levels. Areas outside of existing concessions are believed to offer promising possibilities for exploration. During the last 12 years, however, only one area -- southern Lake Maracaibo -- has been opened up to private companies for exploration. The small scale of this exploration is unlikely to yield results that will offset the prospects of declining production in present concession areas. How this situation might be changed by developing the Orinoco tar belt is unclear. The Venezuelan government estimates petroleum reserves in the Orinoco tar belt at 700 billion barrels, of which 10% could be economically exploited. Surveys done thus far, however, are insufficient to permit reliable estimates of reserves to be made.

<u>Prospects for Spending Oil Prospects</u>

Initially the 1974 budget showed expenditures of about $3.4 billion, but after President Perez was inaugurated, Congress more than doubled spending authorizations. Much of the increased spending was aimed at fulfilling the President's new economic policy of promoting agricultural and industrial development. The proposed 1975 budget, excluding the Investment Fund expenditures, projects a small decline in outlays, reflecting the government's decision to cut petroleum production 10%.

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President Perez has outlined a plan for the use of surplus oil revenues. Half is to be put into an external investment fund insuring a return; the other half is to be used for domestic projects and to fund development in other Latin American countries through multilateral organization. Several domestic projects already are in progress, and the government is subsidizing staple consumer goods to slow the rise in domestic prices. Large increases in military purchases probably are not planned. Defense accounted for 10.2% of the budget in 1974 and 5.0% of the proposed 1975 budget.

<u>Position on OPEC Issues</u>

Venezuela has a strong stake in maintaining high prices and is concerned about conservation of its oil resources. Thus it will strongly support an OPEC scheme to proration output.

Caracas approves the idea of a meeting with consumer countries, particularly if the agenda includes consideration of relative prices for raw materials and finished goods. It strongly advocates OPEC assistance to LDCs and has supported creation of a fund for this purpose.

A firm supporter of OPEC, Venezuela looks upon the organization as a means of helping the exporting countries to extend national control over their oil industries. The government, nevertheless, recognizes the continuing need for technology, marketing, and other services that the international oil companies provide. Venezuela hopes to maintain a mutually profitable relationship with the companies even after they are

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Venezuela: Economic Fact Sheet

	1965	1970	Estimated 1973	1974
	Million Persons			
Population	8.6	10.4	11.5	11.9
	Thousand B/D			
Crude oil production	3,500	3,700	3,400	3,000
	Billion US $			
GNP	7.6	10.2	16.1	17.9
Government oil revenues	1.0	1.3	3.0	8.9
Foreign exchange expenditures	2.7	3.5	5.6	6.7
Foreign exchange reserves	0.8	1.0	2.4	5.7

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